

Calculating Markup: A Merchandising Tool

Part 2: 2-5 Initial Markups

The difference between the original retail price and cost is the **initial markup**. Retailers do not expect to sell all merchandise at the initial markup. Many items have to be marked down to meet customer expectations, create sales volume or clear inventory. Others will be discounted due to customer returns and allowance and/or employee discounts and the retailer always has to plan for inventory shortage or shrinkage due to both employee and customer pilferage.

The initial markup must cover operating expenses, reductions (i.e., markdowns, customer returns and allowances, employee discounts, and shortages or shrinkage), profit, alterations, transportation costs, which usually contain the insurance for shipping the goods, and cash discounts. Note that cash discounts should not be confused with retail reductions. Cash discounts are considered as hidden profit for the retailer, are stipulated in the terms of sale, and are subtracted from the cost of goods when paying the invoice. Cash discounts are subtracted in the numerator of the initial markup formula. (Cash discounts will be discussed in **Section 2, Part 3: 3-4.**) Initial markup is the only markup calculated using gross sales or net sales plus reductions.

The retailer must establish policies when setting initial markup in order to assure adequate operating expenses and profit for the store. Different merchandise categories in the merchandise mix will more than likely have different markups. Different brands and merchandise in the same product classifications are likely to have different markups. For example, if a merchandise item is high fashion with a high markdown risk, or if the merchandise is exclusive to one particular retailer in a geographic location, the retailer might place a higher markup on that merchandise in order to cover the risk. Additionally, the retailer must examine the markup of its competition, especially the markup on designer and national brands. Also, if the handling cost of the merchandise or shipping costs are high, these factors must be considered when establishing the markup and the amount of markdowns on specific product classifications from the previous year must be analyzed when planning markup.

Initial markup is the only markup that relates markup to gross sales. As previously stated, since initial markup uses the first or original retail price, it takes into consideration that not all merchandise sells at the regular or original price. Therefore, initial markup must be carefully planned. Formulas and examples with calculations for initial markup, both dollars and percent, are provided below.

Calculations for all Initial Markup examples (both dollars and percent) are based on the dollar figures below:

Problem:	Gross Sales \$ = 150,000	Customer Return \$ = 1,000
	Net Sales \$ = 130,000	Markdown \$ = 15,000
	Expenses \$ = 60,000	Cash Discount \$ = 2,800
	Profit \$ = 10,800	Transportation \$ = 1,200
	Discounts \$ = 1,000	Alteration \$ = 800
	Shrinkage \$ = 3,000	Cost of Goods \$ = 70,000
		(Invoice Cost \$)

The formulas for calculating **Initial Markup Dollars** are as follows:

Initial Markup \$ = Operating Expenses \$ + Profit \$ + Transportation \$ (usually includes

$$\begin{aligned}
 & \text{insurance)} \\
 & + \text{Reductions } \$ \text{ (markdowns, discounts, shrinkage, customer returns \& } \\
 & \quad \text{allowances)} \\
 & + \text{Alterations } \$ - \text{Cash Discounts } \$ \\
 & \text{OR}
 \end{aligned}$$

$$\text{Initial Markup } \$ = \text{Gross Sales } \$ \times \text{Initial Markup } \%$$

1. Calculate **Initial Markup \$**.

$$\begin{aligned}
 \text{Initial Markup } \$ &= \text{Operating Expenses } \$ + \text{Profit } \$ + \text{Transportation } \$ \text{ (usually includes} \\
 & \quad \text{insurance)} \\
 & + \text{Reductions } \$ \text{ (markdowns, discounts, shrinkage, customer returns \&} \\
 & \quad \text{allowances)} \\
 & + \text{Alterations } \$ - \text{Cash Discounts } \$
 \end{aligned}$$

Example

Problem: (using figures on page 26)

$$\begin{aligned}
 \text{Initial Markup } \$ &= \$60,000 + \$10,800 + \$1,200 + (\$15,000 + \$1,000 + \$3,000 + \$1,000) \\
 & \quad + \$800 - \$2,800
 \end{aligned}$$

$$\text{Initial Markup } \$ = \$90,000$$

OR

2. Calculate **Initial Markup \$**.

$$\text{Initial Markup } \$ = \text{Gross Sales } \$ \times \text{Initial Markup } \%$$

Problem: (using figures on page 26)

$$\text{Initial Markup } \$ = \$150,000 \times 60 \% (.60)$$

$$\text{Initial Markup } \$ = \$90,000$$

The formulas for calculating **Initial Markup Percent** are as follows:

$$\begin{aligned}
 \text{Initial Markup } \% &= \text{Operating Expenses} + \text{Profit} + \text{Transportation (usually includes insurance)} \\
 & + \text{Reductions (markdowns, discounts, shrinkage, customer returns \&} \\
 & \quad \text{allowances)} \\
 & + \text{Alterations - Cash Discounts} \\
 & \quad \div \\
 & \quad \text{Net Sales + Reductions (Gross Sales)}
 \end{aligned}$$

Example

Problem:

1. Calculate **Initial Markup %**.

$$\begin{aligned}
 \text{Initial Markup } \% &= \$60,000 + \$10,800 + \$1,200 + (\$15,000 + \$1,000 + \$3,000 + \$1,000) + \\
 & \quad \$800 - \$2,800
 \end{aligned}$$

$$\begin{aligned}
 & \quad \div \\
 & \quad \$130,000 + (\$15,000 + \$1,000 + \$3,000 + \$1,000)
 \end{aligned}$$

$$\begin{aligned} &= \$90,000 \div \$150,000 \\ &= 60.0\% \end{aligned}$$

(Hint: The formula above can be calculated using either all dollars or all percents.)

OR

2. Calculate **Initial Markup %**.

$$\begin{aligned} \text{Initial Markup \%} &= \text{Initial Markup \$} \div \text{Gross Sales \$} \\ &= \$90,000 \div \$150,000 \\ &= 60.0\% \end{aligned}$$

In conclusion, initial markup is the original or first markup on an item. It is the “hoped for” markup. However, markup usually does not remain constant during a selling season; the items that do not sell within a given period of time (set by each retailer based on consumer demand) must be reduced in retail price. Additionally, merchandise is discounted for both employees and customers throughout the selling season for various reasons. Sometimes items are stolen, broken or damaged. Thus the original retail price must be adjusted in order to sell the merchandise.

In the last segment of **Section 1, Part 2: 2-6, maintained markup** (i.e., the actual achieved markup) will be discussed in relationship to initial markup and gross margin.